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No. 590

In the Supreme Court of the United States

OCTOBER TERM, 1957

AMERICAN PIPE & STEEL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 49–79) are reported at 25 T. C. 351. The opinion of the Court of Appeals (R. 659–664; Pet. 1a–6a) is reported at 243 F. 2d 125.

JURISDICTION

The judgment of the Court of Appeals (R. 665; Pet. 7a) was entered on April 17, 1957. A petition for rehearing was denied on June 4, 1957. (R. 666; Pet. 7a–8a.) By order of Mr. Justice Black, dated

August 29, 1957, the time to file a petition for a writ of certiorari was extended to November 1, 1957. (Pet. 8a.) The petition for a writ of certiorari was filed on October 30, 1957. The jurisdiction of this Court rests on 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether American Pipe & Steel Corporation is entitled to the tax benefits which it claimed in the consolidated returns for 1944, 1945, and 1946, by reason of its acquisition of the entire stock of Palos Verdes Estates, Inc.

STATUTE AND REGULATIONS INVOLVED

Section 45, Section 129 and Section 141 of the Internal Revenue Code of 1939, and Section 29.129–1 of Treasury Regulations 111, are set forth in the Appendix, *infra,* pp. 14–17.

STATEMENT

American Pipe & Steel Corporation, taxpayer, is a corporation principally engaged in the steel fabricating business. In 1943 it acquired the capital stock of a corporation known as Palos Verdes Estates, Inc. (hereinafter referred to as Palos Verdes), and that company became a wholly owned subsidiary of taxpayer. Thereafter, taxpayer and Palos Verdes filed consolidated returns for the years 1943, 1944, 1945 and 1946. The Commissioner of Internal Revenue determined a deficiency in the taxes paid under the consolidated returns by disallowance of the claimed

tax benefits resulting from the acquisition of control of Palos Verdes. In asserting the deficiency, the Commissioner held that the principal purpose of the acquisition was to avoid or evade federal income and excess profits taxes within the meaning of Section 129 of the Internal Revenue Code of 1939. (R. 31, 51–52, 55, 60, 76).

A trial of the case being had, the Tax Court made specific findings of fact on the basis of which it made an ultimate finding based on the language of Section 129, sustaining the Commissioner's determination (R. 75). The Court of Appeals held that the findings of the Tax Court were supported by substantial evidence, and affirmed its decision (R. 664; Pet. 6a).

In its opinion, the Court of Appeals succinctly summarized the findings of the Tax Court as follows (R. 661–663; Pet. 4a–6a):

With the onset of World War II, taxpayer was on the threshold of obtaining many profitable Government war contracts in the metal fabricating field. On September 3, 1942, it received a Government contract amounting to $3,500,000, for the manufacture of gas tanks. Although the contract was later cancelled by the Government in late 1943, taxpayer had a backlog of Government prime and subcontracts of $124,603.29 on December 31, 1943, and a total of $1,892,144.92 of Government contracts awarded during 1944. In short, the prospective profits from war contracts loomed large for taxpayer (R. 661; Pet. 4a).

Palos Verdes had been in poor financial condition since 1936. Its principal assets were 695 residential lots located near Palos Verdes, California. The lots had been held by the corporation for many years,[1] and had a tax basis in excess of $430,000. Their market value, as determined by sale of the lots in December, 1943, and January, 1944, was approximately $25,000 (R. 661–662; Pet. 4a).

Taxpayer acquired the Palos Verdes stock through a nominee, one Robert P. Archer, employed by taxpayer ostensibly as an accountant and expediter for Government contracts. Taxpayer advanced funds to Archer, who began purchasing Palos Verdes shares in 1943. Many outstanding shares were acquired through a general offer of $2 per share, although Archer himself testified that the shares had been selling between 25 and 45 cents per share on the market. After acquiring a controlling interest in Palos Verdes, the remaining shareholders were forced out by a large assessment (R. 662; Pet. 4a–5a).

On December 2, 1943, Archer, who took legal title to the Palos Verdes shares, relinquished them to taxpayer upon cancellation of his indebtedness for the funds advanced to purchase the shares. Immediately, the fiscal year of Palos Verdes was changed to coin-

[1] The lots had been transferred by tax deeds to the State of California in 1938. A decree issuing from an action instituted by Palos Verdes in 1943 allowed redemption of the lots upon payment of delinquent taxes within six months. Most of the lots were redeemed. (R. 662; Pet. 4a)

cide with the calendar year of taxpayer. Less than three weeks later, on December 23, 1943, a liquidation sale of the Palos Verdes lots was held. Of the lots sold, 451 were sold to one Carl H. Dahlberg for his personal note for $18,000.[2] The tax loss from this sale amounted to $232,781.00. On January 15 and 16, 1944, most of the remaining lots netted $16,185 at a public auction, resulting in tax losses of $167,612.91 (R. 662; Pet. 5a).

Thus, for a total cost of $11,248.96 to taxpayer, it acquired tax losses of $400,393.91. Taxpayer caused Palos Verdes to file a consolidated return for the period December 3, 1943, to December 31, 1943, and for the years thereafter (R. 662; Pet. 5a). The resulting offset of taxpayer's gains with Palos Verdes losses, and carryovers of net operating losses, is displayed in the following table and explanation taken from the Tax Court's findings of fact (R. 663; Pet. 5a):

Taxable year	American Pipe Net Income, or (Loss)	Palos Verdes Net Income, or (Loss)	Consolidated Net Income, or (Loss)
1943	$16,880.52	($245,800.74)	($228,920.22)
1944	96,515.44	(419,329.90)	(322,814.46)
1945	144,909.04	(272,164.94)	(127,255.90)
1946	316,644.17	(148,632.80)	(168,011.37)

[2] Dahlberg, now a vice president of American Pipe, reconveyed the lots to the president of American Pipe in 1948 in extinguishment of his debt to American Pipe for funds advanced to pay back taxes due on the lots. Thus. it appears the sale to Dahlberg was a mere sham, designed to accomplish a quick sale of the lots to gain the tax benefits (R. 662; Pet. 5a).

As explained by the Tax Court, the amounts stated in the Palos Verdes column and in the Consolidated column for the taxable year 1944, reflect a carryover of claimed net operating loss of Palos Verdes for the period December 3, 1943, to December 31, 1943, deducted on the consolidated return filed for the year 1944 in the amount of $215,639.88. The amounts stated in the Palos Verdes column and in the Consolidated column for 1945 and 1946 reflect carryovers of claimed net operating losses for the first and second preceding years of Palos Verdes deducted on the consolidated returns filed for 1945 and 1946, in the amounts of $322,814.46 and $107,174.58, respectively (R. 663; Pet. 6a).

On the basis of its fact findings, the Tax Court arrived at the ultimate conclusion that the evidence does not establish that the Commissioner erred in holding "that the evasion or avoidance of income or excess profits taxes by securing the benefits of deductions, credits or other allowances which it would not otherwise enjoy was the principal purpose for which American Pipe acquired the capital stock of Palos Verdes" (R. 75). The Tax Court further pointed out that although intent is a state of mind, it is nonetheless a fact to be found, as other facts are found—"by a study of the entire record and the inferences to be drawn therefrom" and concluded, "After a careful study of the record", that taxpayer had not successfully carried his burden to prove that the Commissioner was wrong in determining that the tax benefit to be gained was the principal purpose behind the acquisition of Palos Verdes (R. 79).

ARGUMENT

1. As both courts below held, the application of Section 129. (Appendix, *infra*, pp. 14–15) to the facts of this case, serves to deny the taxpayer the right to offset Palos Verdes' losses against its (the taxpayer's) profits on the consolidated return filed for the taxable years involved. As pertinent herein, that section denies deduction, credit or allowance where a taxpayer has acquired on or after October 8, 1940, at least 50 per cent control of a corporation, the "principal purpose" of whose acquisition was avoidance of federal income or excess profits taxes by receiving the benefit of a deduction, credit, or allowance which such taxpayer would not otherwise enjoy. The question of "purpose", that is, the intent with which the acquisition was made, is one of fact for the trial judge to determine. *Alcorn Wholesale Co.* v. *Commissioner*, 16 T. C. 75, 89. Here two courts, after a review of the entire record, have sustained the Commissioner's determination that the principal purpose of the acquisition by taxpayer of the Palos Verdes stock was one of tax avoidance. In view of these concurrent findings, there is no warrant for review by this Court. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214.

2. In support of its petition, taxpayer contends (a) that the findings of the Tax Court are insufficient, incomplete, and inconsistent; (b) that the ultimate finding of the Tax Court is not sufficient to support its judgment since it is more in the nature of a legal conclusion based upon the presumptive correctness

of the ~~court's~~ Commissioner's determination, than a finding of the underlying facts; and (c) that the Court of Appeals overstepped the bounds of appropriate appellate review in that its examination of the record was not limited to a determination of whether the findings of the Tax Court were supported by substantial evidence, but rather served as a basis for making findings of its own. These contentions are wholly without merit.

(a). As to the first contention, taxpayer ignores the fact that it is the function of the Tax Court to pass upon the credibility of witnesses, weigh the evidence, and draw reasonable inferences therefrom. *Helvering* v. *Nat. Grocery Co.*, 304 U. S. 282, 294–295; *Helvering* v. *Kehoe*, 309 U. S. 277, 279; *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37, 40. Equally well established is the Tax Court's power to choose between conflicting inferences. *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, 168. It was not incumbent upon the Tax Court, therefore, to make a finding with respect to every item of evidence submitted to it, nor to accept all evidence offered as a fact. The Tax Court was here concerned with the ultimate fact of whether the principal purpose in the acquisition of Palos Verdes by taxpayer was one of tax evasion or avoidance. The Tax Court found taxpayer's intent, "as other facts are found—by a study of the entire record and the inferences to be drawn therefrom," (R. 79) and the record amply supports its finding. Its affirmative finding in this regard was concurred in by the Court of Appeals and is not clearly erroneous. See *United States* v. *Gypsum Co.*,

333 U. S. 364. Moreover, evidentiary facts cannot be used to overcome a finding of ultimate fact unless they compel an opposite conclusion as a matter of law. *Botchford* v. *Commissioner*, 81 F. 2d 914, 917 (C. A. 9th); *Tricou* v. *Helvering*, 68 F. 2d 280, 283 (C. A. 9th). Taxpayer here makes no contention that the alleged insufficiencies or incompleteness of the Tax Court's findings would compel a conclusion opposite to that reached by the Tax Court.

(b) With respect to its ultimate conclusion or finding, the Tax Court specifically stated (R. 75) that it was arrived at "On the basis of the foregoing facts * * *"—i. e., the evidentiary findings which themselves stemmed in substantial part from the adoption of stipulated or undisputed facts (R. 51, 75). Indeed, in its own statement of the facts of the case, taxpayer relies principally upon the findings of the Tax Court and admits that "Many of these facts were stipulated and few, if any, are in dispute" (Pet. 6). Again, in its opinion, the Tax Court, after pointing out that it was taxpayer's burden to prove that the Commissioner's determination was erroneous, recited that its conclusion that taxpayer had not successfully carried its burden of proof was made "After a careful study of the record * * *." Obviously, then, the Tax Court's ultimate finding was more than a legal conclusion based on the presumptive correctness of the Commissioner's determination. It was, in fact, a finding based upon the "evidence" and the "record made" (R. 75, 79). The Court of Appeals was of the same opinion (R. 660; Pet. 2a–3a).

Further, the Court of Appeals, after pointing out that by invoking the jurisdiction of the Tax Court the taxpayer undertook the burden of establishing by a preponderance of evidence that the determination made by the Commissioner was erroneous,[3] also stated that the Tax Court's finding was "an express finding of failure of proof, which, if substantially supported by the evidence requires an affirmance of its [the Tax Court's] decision" (R. 661; Pet. 3a-4a). The court below thereupon proceeded to examine the evidence of record and concluded that the Tax Court's findings were supported by "substantial evidence" (R. 664; Pet. 6a). This was in accord with its function and duty (*Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164, 168) and, contrary to the assertion made by taxpayer, did not constitute a substitution of its view of the facts for that of the Tax Court.

(c). With respect to its third contention that the Court of Appeals exceeded the scope of its reviewing function and made findings of its own, the taxpayer lists (Pet. 23–24) four findings allegedly made by the Court of Appeals rather than the Tax Court. We submit, however, that, at most, these alleged findings are merely summary statements of findings which the Tax Court made. Thus, as to the statement by the Court of Appeals (Pet. 23; 5a; R. 662, fn. 5) that the sale of the Palos Verdes lots to Dahlberg was a mere sham designed to accomplish a quick sale to gain the tax benefits, the Tax Court found that the sale to Dahlberg by Palos Verdes in December, 1943,

[3] Rule 32 of the Rules of Practice of the Tax Court; *Helvering* v. *Taylor,* 293 U. S. 507, 515.

was with the approval of taxpayer corporation; that Dahlberg was personally unable to supply any funds for their purchase, but rather gave his personal note therefor in the amount of $18,000; that shortly after the sale, Dahlberg was unable to pay taxes due on the lots and was forced to borrow the tax money from Palos Verdes giving his note therefor; that four years later in January, 1948, when Dahlberg deeded the lots to Lane personally, he retained no legal or equitable interest therein other than a remote contingent interest; and that even at that time he was unable to supply funds for taxes on the lots (R. 62–63). The clear import of these findings is that the sale of the lots to Dahlberg was a sham, and calling it such, as the Court of Appeals did, does not constitute the making of a finding of fact.

As to the second alleged finding by the Court of Appeals that taxpayer acquired the Palos Verdes stock through a nominee, one Robert P. Archer employed by American Pipe (Pet. 24; R. 662), the findings of the Tax Court show that Archer was employed by taxpayer in the nominal capacity of an "expediter" and accountant (R. 56–57); that immediately thereafter an escrow bank account was opened in Archer's name with money advanced by taxpayer; that shares of Palos Verdes stock were obtained by Archer through this escrow procedure; that at the time the escrow account was opened Archer personally was without funds, had alimony commitments, and was very close to being "broke"; that the formal offer made to the owners of Palos Verdes stock was signed "R. P. Archer, Nominee"

(R. 57–58); and that in bidding upon and purchasing 96 shares of the stock at an assessment sale, Archer was acting for, and used funds furnished by, taxpayer for that purpose (R. 60). The statement made by the Court of Appeals, therefore, is but in recognition of, and is amply warranted by, the findings of the Tax Court in this respect.

The third alleged finding by the Court of Appeals (Pet. 24, 6a; R. 663), that any corporation formed to do business in the real estate field would have satisfied the alleged needs of taxpayer, is followed by the explanation (R. 663; Pet. 6a) that the reasons advanced by taxpayer that its acquisition of a practically defunct corporation was the potential value of the lots "does not overshadow the conclusion that the acquisition was for a huge potential tax benefit." Furthermore, in both its findings (R. 69–72) and opinion (R. 77–78), the Tax Court took note of the alleged reasons given by taxpayer for the acquisition of Palos Verdes including that of acquiring a real estate company having powers broad enough to engage in certain auxiliary activities which were in competition with those to whom taxpayer was selling its products. The Tax Court was not persuaded that the acquisition of this particular corporation (Palos Verdes) was other than for the principal purpose of obtaining tax benefits not otherwise available to it.

Finally, the fourth alleged finding by the Court of Appeals (Pet. 24, 6a; R. 663–664) that within two months of acquisition Palos Verdes was a "mere corporate shell" is not an element essential to the application of Section 129, although, as that court ob-

served, it was highly significant as militating against taxpayer's contention of non-tax motivation. Again, the court below only reflected the facts as found by the Tax Court, namely, that by December 2, 1943, taxpayer had become the owner of all the outstanding shares of Palos Verdes (R. 60), and that by the end of January, 1948, that company no longer owned the lots which constituted its principal asset R. 53, 62–65).

CONCLUSION

This case turns upon its own facts, there is no conflict of decisions, and the decision of the Court of Appeals is correct. The petition for writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 45 [As amended by Sec. 128 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21]. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U. S. C. 1952 ed., Sec. 45.)

SEC. 129 [As added by Sec. 128 (a) of the Revenue Act of 1943, *supra*]. ACQUISITIONS MADE TO EVADE OR AVOID INCOME OR EXCESS PROFITS TAX.

(a) *Disallowance of Deduction, Credit, or Allowance.*—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the trans-

fero corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

(b) *Power of Commissioner to Allow Deduction, Etc., in Part.*—In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

(26 U. S. C. 1952 ed., Sec. 129.)

SEC. 141 [As amended by Sec. 159 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. CONSOLIDATED RETURNS.

(a) *Privilege to File Consolidated Income and Excess-Profits-Tax Returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. * * *

* * * * * *

(d) *Definition of "Affiliated Group".*—As used in this section, an "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common

parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

* * * * *

(26 U. S. C. 1952 ed., Sec. 141.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.129–1 [As added by T. D. 5426, 1945 Cum. Bull. 196.] *Meaning and Use of Terms.* —As used in section 129 and in sections 29.129–2 to 29.129–5, inclusive—

(a) The term "allowance" refers to anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a deduction, a credit, an adjustment, an exemption, or an exclusion.

* * * * *

(e) The term "person" includes an individual, a trust, an estate, a partnership, a company, or a corporation.

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